Elvira Nabiullina: Review of recent inflation developments in Russia

Statement by Ms Elvira Nabiullina, Governor of the Bank of Russia, in the follow-up to the Board of Directors meeting, Moscow, 24 March 2017.

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Today the Bank of Russia Board of Directors decided to reduce the key rate to 9.75 p.a.

The economic situation is more favourable than we expected in December 2016. The upturn in the economy has started earlier and is progressively gaining sustainability. The balanced growth in supply and demand exerts no considerable inflationary pressure. Inflation is slowing down faster than we predicted. Inflation expectations continue to go down. These developments favour a change in the key rate. We reduced it today by a quarter percentage point and we are looking into further cuts in the second and third quarters of this year.

At the same time, we need to be convinced that the positive trends will gain momentum. We need to see inflation not just slowing down, but anchoring near the 4% target. Therefore, inflation expectations should be anchored at this level. Inflation risks have abated somewhat for now, but they may materialise over the forecast horizon. Therefore, we will reduce the key rate progressively in the medium term and are likely to take short pauses while sticking to moderate tightness in our monetary policy. We will mostly rely on our pivotal meetings when we update and release our macroeconomic forecast whereon our decision is based. Having said that, we do not rule out that a decision may be made at one of our intermediate meetings.

Let us have a closer look at the factors behind today's decision.

First, inflation has slowed down considerably. It stood at 5.4% in late 2016 and fell to 4.3% as of 20 March. It is very close to the 4% target.

Inflation reduction is driven by a number of factors. Price growth is primarily checked by slack consumer demand. Some indicators suggest that it started to slowly recover in early 2017. However, overall households retain the propensity to save, of which deposits are indicative. Incentives to save are supported by positive real interest rates.

Lowering inflation expectations also slow down consumer price growth, though they are still high. Expectation indicators sometimes wobble up and down and we speak about their volatility. Having said that, the most important development is that a downward trend has entrenched.

The ruble appreciation triggered inflation to reduce faster than forecast. It has affected all goods and individual services in recent months, especially food prices. Prices for some products, such as fruit and vegetables, even dropped, because they quickly respond to a changing environment. That said, it also means that the situation may abruptly reverse for such goods. Exchange rate movements also decelerated growth in non-food goods and service prices.

Another factor is heavy crops last year and in 2015. They have left stocks of farm produce which drag down prices for some food products. This effect was expectable but proved to be stronger.

The contribution of exchange rate fluctuations and heavy crop to inflation slowdown may decline in future. We took this into account when choosing the scale of key rate reduction.

The Bank of Russia maintains a focus on the analysis of inflation trends in the regions. Although most regions are enjoying slower inflation, it still varies considerably. February data suggest that annual inflation in the regions ranged between 1.9 and 6.4%. Differing readings for price growth across regions are explained by a number of factors including households' capacity to pay, the level of competition, industrial specialisation and the policy of local authorities. Monetary policy checks overall inflationary pressure; yet, regional differences will persist, albeit, as we foresee, will diminish progressively.

Inflation may also vary across households with different incomes. Early last year, these differences became stronger. This year we are witnessing lower inflation almost in all income groups, except for highest income households. Inflation in medium and low income households is approaching the 4% target, which is certainly a positive trend. This lays the groundwork for soundness of households' savings and incomes.

Second, a more sustainable economic recovery does not trigger inflationary pressure.

The updated Rosstat data suggest that the downturn in the Russian economy was not so deep in 2015–2016 and the economy saw a recovery earlier than expected. If we compare this situation with the overall economic crunch of 2008–2009, we can see that GDP dropped over 10% at the time, while in 2015–2016 it contracted by slightly more than 3%, given that the oil price drops were similar. We will be able to revise our estimates in April, when Rosstat publishes its updated statistics for 2016. Preliminary estimates suggest that GDP started showing quarterly growth as soon as 2016 Q2 (Q3 according to previous estimates). Annual industrial production growth entered positive territory in the first quarter of last year. Estimates of industrial production statistics for the beginning of this year need calendar adjustment. This February is two working days shorter than last year, which results in different volumes. If adjusted for this factor, industrial production continued to expand, adding more than 1% YoY in February. This calendar effect will also manifest itself in overall Q1 readings.

After a long period of instability, we can see clearer signs of investment recovery. Production and imports of investment goods are growing. Surveys confirm that investment demand is on the rise. Businesses are building up stockpiles as they expect demand to recover. These expectations may soon prove right. We predict consumption to increase in annual terms as soon as the second quarter. It will come after expansion in production and will not create inflation risks.

Third, the short-term risks stemming from Finance Ministry operations have not materialised.

As we were making the key rate decision in February, the Finance Ministry was then yet to launch its forex operations as part of the budget rule. It was difficult to gauge the envisaged impact of such operations. The Finance Ministry-conducted purchases of foreign currency could have fomented a short-term deterioration in exchange rate and inflation expectations. Given a number of risks including these, we toughened our rhetoric at the time. To date we see that the foreign currency market has remained steady. The impact of these operations on the ruble exchange rate was immaterial if its strengthening factors prevailed.

Fourth, the updates to the outlook are mainly related to 2017, with the mid-term prospects for economic development unchanged.

A conservative approach to the baseline scenario assumes oil prices to drop to $40 a barrel by the end of 2017. In this case, the average annual oil price will hold near $50 in 2017, that is, well above the previous scenario's assumptions. It would be difficult at this point to make a definitive forecast as regards the potential extension, in the middle of the year, of oil producers' output cut deal. This is indeed an uncertainty factor. Oil prices may also be under downward pressure coming from rising outputs of shale oil, as well as a potentially stronger dollar on the back of the US Fed rate rise.

In a scenario when we see oil prices slump from the current relatively high levels, both business and household expectations are set to be negatively affected for a time. However, we expect no reversal in the current positive economic trend. We cannot rule out a certain slowdown in the paces of growth between late this year and early next year; yet subsequently, the economic trends of today will prevail. Businesses will be gradually building up investment as they capitalise on their profits accumulated in prior years. The real sector's ability to borrow will also improve over time. Alongside with softer monetary conditions, this will give extra impetus to growth in investment. Consumer demand will recover gradually on the back of growing revenues and improving expectations. This process is expected to be smooth and create no inflation risks. The recent strengthening in the ruble is set to bring about increased demand for imports in the first half of 2017. Moving forward, however, this growth is on course to become slower; in this way, exports are set to grow at moderate paces.

In 2017–2018, economic growth will total about 1-1.5%, with acceleration to 1.5-2% envisaged as early as 2019. Still, potential economic growth will be invariably constrained by structural factors. Following this recovery period, paces of GDP growth are expected to be equal or less than 1.5-2%.

The current account balance is expected to rise in 2017, prompted by higher oil prices. It will decline in the course of 2018, triggered by a slump in oil prices that the forecast assumes. Capital outflow will remain low and under $13 billion helped by, among other things, a drop in net external corporate debt payments.

Banks are expected to fully pay out their forex repo debt in the course of 2017, which is estimated, alongside the Finance Ministry-conducted foreign currency purchases, to help foreign currency reserves grow by as much as $23 billion.

The baseline scenario assumes that a reduction in oil prices will trigger no growth in inflation, which will continue to slow down on track to reach 4% before the end of 2017 and will be subsequently maintained near this level on condition our monetary policy remains moderately tight.

Fifth, the risks that we may fail to deliver on the target for inflation by late 2017 have gone down. The outrunning slowdown in inflation to date is seen as a margin of safety going forward. At the same time, risks remain that inflation may fail to become anchored around the target level in the medium term.

We see output prices accelerating growth across several core industries including oil production and metallurgy. This may have negative implications for costs and, as a result, for the economy overall. Should the baseline scenario that assumes a correction in oil prices materialise, this factor is expected to have only a minor and short-lived impact on inflation.

The current inflation risks are also related to the deterioration in some global food markets. In particular, we currently see growth accelerating in prices for dairy products, meat and sugar.

The tax policy measures under discussion may have pro-inflationary implications, to be estimated once more clarity is available on the scale of proposed changes.

Also, the risks that inflation expectations will decrease too slowly are still there. It is important to take into account that inflation expectations are sensitive to other risks materialising, for instance, to the risks of fluctuating prices in commodity and merchandise markets. These may be affected by even an upsurge in prices for only individual goods or services – for example, those frequently purchased. Growing inflation expectations, in their turn, may reinforce the impact of various one-off factors on prices. As we look into these trends, we put household expectations in the first place. On the side of analysts' expectations, these continue to decline and on track to approach the target level of inflation. This is a truly positive trend considering that companies may well be guided by analysts' estimates in their decision-making – and it is companies that determine prices and wages.

As I have mentioned on several occasions before, we are seeking more than a one-time reduction in price growth to 4%. It is important to anchor inflation near this level in future. For this reason we call this situation price stability, i.e. sustainably low inflation.

To maintain inflation close to its target level, moderately tight monetary policy may be needed over a two-three year horizon. This is necessitated by the still high sensitivity of inflation to one-off factors, as well as its inertia and elevated inflation expectations. As they stabilise close to the target level of inflation, prices are expected to be less responsive to various short-term factors. These new conditions would see no need for additional tightening in the monetary policy stance to ensure that inflation holds near 4%.

This conservative strategy in monetary policy may appear unattractive short-term; however it will enable us to deliver on a more sustainable result in the mid-term, that is, deliver on the objective to establish in Russia a low price and cost growth environment – such that favours both households and businesses, as well as the overall economy.

Q&A for the Media

QUESTION from Vedomosti:

Given the Bank of Russia's move to reduce the rate and its guidance that further rate reduction is not impossible in the second and third quarter, does that suggest that the Bank of Russia has launched a monetary loosening cycle?

ELVIRA NABIULLINA:

An easing cycle is understood as a process of sequential rate reduction, decided at each policy Board meeting. Having said that, we acknowledge that the sequence of rate cuts may be interrupted, though this would not run counter to an overall mid-term downward movement of the rate. We will move forward with care and precision. For the most part we will be largely guided by economic data as well as, certainly, by our forecasts. Under such uncertain circumstances and present risks of inflation we are unable to state with certainty that this move constitutes the start of a recurrent easing cycle, to be continued upon decision at each forthcoming Board meeting. However, we are not ruling this out as a likely possibility, conditional on a sufficiently positive outlook.

RIA Novosti's QUESTION:

According to a recent statement issued by the Ministry of Finance, inflation is expected to decrease to 4% as early as in the first half of the year. In any case the Bank of Russia predicts that the target for inflation will be hit by the end of the year. Could you please comment on any risks the Central Bank sees in this potential over-performance? Can the Central Bank have estimated a divergence, of critical importance, from the target in this case? If so, what is the extent of this deviation? Is there any risk that inflation will get stuck above 4%? And are there any risks associated with a rate of inflation of around 3%? Have you made any critical calculations of a twofold estimate? And if not, when do you intend to do so? Thank you.

ELVIRA NABIULLINA:

Our goal is to ensure that inflation remains *around* 4%, a target we have always spoken of. In other words, it is impossible to expect that the rate of inflation will work out to be precisely 4% every single day. An economy being a living organism, it is only natural for inflation to hover around 4%, that is, slightly higher or slightly lower on any given day. This figure may appear as early as this year. This is a completely normal situation, without any indication of risk whatsoever. This is the way it should be. Risks may emerge only if we see either a substantial or lengthy deviation in the rate of inflation in either direction from the 4% target.

You will recall that in the early days of inflation targeting this range was defined as 4% plus or minus 1.5 percentage points. We rejected this range, for the following reason: we did this because both analysts and market players were of the opinion that we were aiming for a point outside the middle of this band, with expectations tending towards its upper limit. We decided to put the plug on this scheme and make known our intentions to ensure a sustainable downward movement in the rate of inflation towards the target.

However, we leave open the possibility for this variation range to be reinstated once we have hit our 4% inflation target. Such a range exists in many economies, and it is open to variation. I think this issue will be on our agenda this autumn as we develop our Monetary Policy Guidelines; at this time we will look into the need for this range and its potential impact on our communication policy. Thank you.

QUESTION from Reuters:

Your press release allows for a gradual downgrade in the key rate. Is this to say that a 25 basis point reduction in future is the new normalcy?

ELVIRA NABIULLINA:

Thank you very much. It is true that we have decided on this magnitude of reduction – 25 percentage points after long time. A short while ago, I floated the idea of a smaller step as we transition progressively to a single-digit rate. This is understood to be standard practice when the key rate is below 10%. Yet, this is not to say that each policy meeting will decide in favour of a 25 bp reduction. I leave open the possibility of a further 0.5 bp reduction provided that the right conditions are in place; however, I envisage that a 0.25 reduction is likely to be more acceptable in the near future.

QUESTION from Interfax:

Two questions, please. First. Last autumn, the Central Bank issued a public statement that it was crafting guidance for civil servants, in an effort to mitigate the volatility of the exchange rate. Can you please update us on the status of this guidance? For which civil servants is this intended? Does this initiative remain current in light of recent statements that suggest a general over-strengthening in the ruble and that they weigh in on the exchange rate?

And another question, if I may. Recently, we have heard heavy criticism against Rosstat. What is the Bank of Russia’s view of Rosstat statistics? Do you think this authority should remain independent, or should it once again be subordinated to the Ministry for Economic Development? Thank you.

ELVIRA NABIULLINA:

Many thanks for your questions. As for the guidance you mentioned – this is still in the works. It is not so simple, as we are all accustomed to comment on a variety of processes. This is common practice when experts, business representatives and governmental officials voice their opinions on the current economic and forex situation. In other countries these opinions are not usually referred to as verbal interventions – verbal interventions are normally understood as the statement of a central bank, and are taken as verbal interventions, as well, possibly, forward guidance, too.

I think that markets will gradually adopt the right view of such communications, and become accustomed to them. At the same time, we are looking to develop some general rules in this area. The idea is to ensure a more careful approach.

On the subject of Rosstat, there are objective complexities. These are understood to arise when Rosstat makes estimates in the context of significant external changes, which causes structural shifts to take place. These changes have to be reflected in data series as they unfold – so as a result we are not immune to recalculations. While we do use the full set of Rosstat data, we have always drawn on additional data obtained through surveys. Our special focus is currently on information coming in from regions using our network. Leaders of the Bank of Russia's regional branches are invited to each of our rate-setting meetings. They update us on the situation in their regions; ultimately, our estimates and outlooks are not solely based on the data provided by Rosstat.

Rosstat data should indeed be treated as a reliable source of information, considering that alongside authorities virtually all market participants also use them. So, the more trust in Rosstat's professionalism and independence the better. There are a variety of options on how we may address this. At the end of the day I believe this is up to the Government. I would rather reserve my judgement here. Thank you.

QUESTION from Bloomberg:

Two questions, again, please. One, following up on the question from my colleague, we heard both the economic development minister and the finance minister mention that the ruble is stronger than its fundamental values. In this connection, what does the Bank of Russia make of this; is the ruble close to its fundamental values, or is it actually stronger?

And my second question, which is in some way related to the first. You mentioned that purchases of foreign currency are a possible means to replenish reserves, provided these purchases do not do damage to inflation targets. All indications are, we are on track to meet the 4% inflation target by mid-year. Can the Central Bank launch foreign currency purchases to replenish its reserves? Thank you.

ELVIRA NABIULLINA:

Thank you. On the subject of the fundamental value of the exchange rate. It's true that this concept is employed by many experts, and so too by us; we have expressed this on several occasions. However, this concept must be treated with great care. My view is that this is a very conditional concept. We at the Bank of Russia have a number of models to measure this basic reading of the exchange rate. It would be fair to say that we estimate this deviation to be much smaller than does the Ministry of Finance. According to other models these deviations appear smaller.

But in any case, what exactly is the fundamental rate of exchange? This is the rate of exchange necessitated by the current balance of payments, current account and capital outflow combined. Yet it is anyone's guess to gauge the exact influence of basic and short-term drivers on this value. This is, as I have previously stated, a very conditional concept. As we see it, in a floating exchange rate environment, as we see it, no matter what deviations are in place, the impact from objective factors will ultimately result in an equilibrium which brings the interests of exporters, importers and borrowers into balance. In our view the issue should be addressed in this way.

Second. Our reserve replenishment policy. Our strategy remains: when favourable conditions arise we will be able to replenish our foreign currency reserves to boost our safety cushion, improving both economic resistance to external shock and financial sustainability, with the understanding that forex reserves are a key instrument. Let me say again though that our current forex reserves, by international standards, are adequate; they are high.

In this context, we are invariably committed to a policy of supplementing forex reserves only when we see no risk to our 4% target, nor to this target in the mid-term. This [resumption of forex purchases] would take place after evaluation of all factors. We have not yet made this decision.

QUESTION from Bloomberg:

Does the regulator support the Finance Ministry-proposed tax manoeuvre whereby VAT would be raised to 22% and the rate of insurance payments lowered to 22%? Did you take into account potential changes to the tax system in your forecasts, including monetary policy for this year?

ELVIRA NABIULLINA:

Just as I said, any tax manoeuvre or a change to the tax system may have implications for inflation, and this should certainly be taken into consideration. It is difficult to provide any estimates until such a time as we know the magnitude of these moves. A few options and ideas are on the table, which relate to areas beyond VAT and social payments. There is too much debate.

Certainly, we have made preliminary assessments of the options. These preliminary estimates suggest a one-off inflation impact of 1 to 2 percentage points. Moving forward, the impact would ride on the range of products affected, as well as, among other things, on the timeline: whether it would be a one-step or a two-step move. The many unknowns in this area prevent us from making any final estimates.

When making this decision we certainly took into account that potential changes to the tax system are not impossible. These have been discussed and will be discussed moving forward. While we are on this subject, we would like to ask the Government to make the parameters of these initiatives known before they are implemented so these could be reflected in our monetary policy, enabling a consistent and smooth monetary policy stance. This is what we would like of the Government in relation to tax reforms.

QUESTION from TASS Agency:

When you reviewed lending to the economy, were you guided by certain adjustments to the macroeconomic forecast?

Also, could you please comment on capital outflow. Were there any revisions in the three-year estimate? Thank you.

ELVIRA NABIULLINA:

Yes, we have indeed made some corrections. Overall, as I have noted, our assessment of 2017 is more positive, while 2018–2019 assumptions are unchanged. This does indeed translate into movement in various indicators.

On the subject of lending, we are expecting growth, and we expect this growth to be gradual and sufficiently smooth. The banking system's capital stock is adequate to boost lending; we do not foresee any growth in outstanding liabilities and, at the same time, profits are sufficient to enable capital buildup. The question is, what procedure will banks use to assess borrowers' risks and how will demand for capital rise. The current volume of lending is indeed growing, albeit at a very moderate pace: around 5-7% for this year.

Turning now to capital outflow. As we see it, capital outflow is expected to remain steady – in the range of $12–13 billion a year over a three-year horizon.

Rossiiskaya Gazeta's QUESTION:

Mrs Nabiullina, the Bank of Russia has recently closed submission of *debt load calculation and use* proposals. What feedback did you receive from the market? What is the timeline for the rollout of this instrument?

And my second question, if I may. You met the People Bank of China's governor, discussing yuan-denominated OFZ. Did you reach an agreement on investment quotas for our securities? Thank you.

ELVIRA NABIULLINA:

As regards the rollout of the debt load indicator, we believe this is absolutely the right approach, and we intend to move forward in this direction. We are still receiving feedback. We will need time to process and consolidate this feedback. No final conclusions are possible at this point, our approach being though that this indicator should be enacted; the timeline and details to be discussed.

As for my meeting with the governor of China's central bank. Yes, we met on the sidelines of the G20 meeting for finance ministers and central bankers. In our talks we discussed, among other things, prospects for yuan-denominated OFZ to be issued on the Russian market. We not support for this idea in principle, with details to be discussed subsequently.

Lenta.ru's QUESTION:

There are concerns in business circles and in the expert community that the ruble is too volatile. What is the Bank of Russia's view on this matter? What could lead to the Central Bank giving up the floating exchange rate?

ELVIRA NABIULLINA:

In the foreseeable future, I do not anticipate any factors which would force us to abandon a floating exchange rate regime. I am convinced that the negative repercussions cited by enterprises in the real sector of the economy, namely, volatility, are outweighed by the benefits of this policy. Thus we are saved from any drastic corrections in the exchange rate, which would then hurt the economy overall, including social expenditures, etc.

Allow me to stress this point again. We are confident that the arrival of the floating rate regime has in many ways helped the economy adjust to external shocks more quickly than it did in 2008–2009. This is also suggested by the depth of recession. It was the floating regime arrangement that enabled the real sector of the economy, together with the financial sector, to adjust to a drastically different environment. This really is an inbuilt stabiliser, and we see that it does work.

The disadvantage of this approach at the time of its rollout was that this policy decision coincided with a drop in the price of oil, triggering a surge in inflation, which in turn necessitated a rise in the rates. But you will recall that we saw a comparable drop in the price of oil in early 2016 which had almost no impact on inflation. These are signs of an economy which is becoming accustomed to a floating rate and how it works. In my opinion this is where the floating exchange rate demonstrated its positive role as an economic adjustment enabler.

We are indeed scared of floating schemes in the economy, explained by the many decades of a fixed exchange rate which changes only during a crisis, such as a devaluation crisis, and aside from which remains permanent for a period of time. Admittedly, this volatility of the exchange rate is a concern. But I will remind you that when the exchange rate was permanent, our interest rates were very volatile, as were other prerequisites to business. Therefore, it will take some time for the economy to adjust to some volatility. This is number two.

Third. Volatility receded drastically following the introduction of the floating exchange rate. It was very high according to various measures: both realised volatility and implied volatility, monthly and three-monthly. It is now down to levels seen in other emerging markets, possibly even lower. Moreover, it is substantially lower than oil volatility. It was assumed previously that as long as oil is overly volatile, the ruble remains equally as volatile. Yet the volatility of the ruble is lower than that of oil.

It will take a further diversification of the economy to enable basic conditions for bringing down volatility. The current developments call for further promotion of forex hedging instruments. We see demand emerging for these instruments, which is why we welcome the initiative of the Government's Ministry for the Economy for the establishment of a dedicated facility to support businesses in hedging forex risks.

QUESTION from TASS Agency:

Another question about the ruble and oil, if I may. The Brent crude price has dropped by almost 13% since the start of the year. The ruble has appreciated against the US dollar by roughly 7% in the same period of time. Does the Central Bank monitor the ruble's dependence on oil? Can you estimate how long this weakening of the ruble's dependence on oil will last? Thank you.

ELVIRA NABIULLINA:

Your question clearly demonstrates that the ruble is not only affected by oil. The oil elasticity of the exchange rate depends on seasonal factors, among others. On some occasions we have registered the elasticity ratio at 0.9, it has even reached 1 during short periods. According to our estimates, it now stands at 0.2-0.3. You will see that the movement may even be reversely directed if other, more serious, factors affecting the exchange rate are in place. The exchange rate is governed not only by oil – oil is an important factor, but not the only one to influence the exchange rate.

The depreciation of the ruble was also largely triggered by typical seasonal variation in the current account – the current account usually shows stronger performance in the first quarter, irrespective of oil prices. The second factor is the growth in oil prices and oil sales by exporters. The third factor is important but the Central Bank believes that it should not be overestimated or exaggerated. I am referring to certain inflows of capital, which are comparable to the inflows of foreign capital to emerging markets.

Further developments will depend on many factors: oil price movements, the Fed's policy, strengthening or weakening of the exchange rate, and the strength of our economy. There are many forces at play here.

QUESTION from TV channel Russia-24:

Mrs Nabiullina, you have already mentioned that the Central Bank will support Russian state-owned banks affected by sanctions in relation to the situation in Ukraine. What specific measures are you going to take? Thank you.

ELVIRA NABIULLINA:

I would like to repeat and emphasise that we do not see any risk to financial stability of our credit institutions even if their investments in Ukrainian assets depreciate completely, because they account for only a very small share of their assets. Therefore we do not see any systemic risks here. Our banks have already created or are creating provisions for such assets. Nevertheless, given the contingencies, we decided that for their convenience they will be allowed a three-year deferral in the creation of provisions on Ukrainian assets.

RIA Novosti's QUESTION:

I wanted to ask, you said that the Central Bank was developing an action plan to reduce inflation volatility through non-monetary measures, among others. What kind of instruments have you already developed? This is the first question.

And question two. Have you revised your risk and optimistic scenarios for the next three-years? Thank you.

ELVIRA NABIULLINA:

Inflation volatility may in fact be determined by non-monetary factors which we are also taking into account. We think it is important to tackle these factors in cooperation with the Government and regional authorities to reduce inflation volatility. In fact, the regional analysis mentioned today also demonstrates that inflation dynamics depend primarily on a competitive environment. For example, inflationary pressure is lower in those regions where local authorities are pushing for agricultural fairs to bring produce to the market. There are also factors related to natural monopolies, and so on.

We have already held an expert discussion. Our Monetary Policy Department is onto it. We invite experts to map out such non-monetary risks and specify measures to tackle them. However, these efforts are still underway – we are at present actively engaged in this process.

Your second question was about the risk and optimistic scenarios.

We have left the baseline parameters largely unchanged, i.e. oil prices in the risk scenario stand at $25 a barrel in 2018–2019, and fall to this level by the end of 2017. We have updated some internal parameters. They will be published today in the Monetary Policy Report. We have kept those predictions in the scenario with growing oil prices, at $55–60; there have also been some minor revisions but general trends remain unchanged. In essence our estimates have not changed since last December.

RBC Media Holding's QUESTION:

Two questions, please. First. You have cited many factors which favour the rate cut, but the significance of constraining factors remains relatively unclear. Do they include uncertain fiscal policy and reshuffles in the Ministry of Economic Development? Could you please repeat what prevents you from reducing the rate more rapidly and why the rate of reduction is 0.25 pp – is this a new norm?

And question two. Economists say that the key rate is losing significance in terms of the economy, i.e. businesses are watching it less closely. Do you see any considerable difference between 9.75% and 9.5%? How important is the key rate at this time?

ELVIRA NABIULLINA:

Indeed, we took into account many positive factors as we made the decision to cut the rate, however inflation risks still persist. We consider them more likely to be medium-term than short-term risks. Monetary policy takes effect with a lag of six to nine months, therefore when in making a decision we have to bear in mind its effects not only this year, but also in 2018. It is very important for the economy to have inflation anchored at 4%.

What stands in the way? The uncertainty of external factors, including oil prices. We are conservative about it and therefore will pursue our monetary policy, and easing thereof, with great care and precision, taking these external factors into account. Households still have high inflation expectations. There is a risk that they will be too slow in verging towards our inflation target. This is also a risk which may sustain conditions of high inflation.

Taxes are still adding to the uncertainty. However, we realise that at some point forthcoming tax decisions will have inflation repercussions. Certainly, we have taken all of these factors into account.

Again, we assume that we will always analyse the situation, analyse newly received data on the current situation, revise our forecasts and make decisions accordingly.

I have already said that we believe 0.25 pp to be an appropriate pace for reducing the key rate to a specified level, which we have actually already reached. However, we may deviate from this pace of 0.25 pp during this period. Is there any difference between 9.75% and 10%, and does our rate work? The rate works, as we can clearly see. It effectively determines short-term rates on the money market and ultimately translates these into rates on bank loans and deposits. This takes effect with a certain lag. We are continuously estimating this lag, which is quite small and adheres to the standard accepted in other countries. Therefore, even the reduction of 0.25 pp may drag down rates for the ultimate borrower. Having said that, risk assessment factors for specific borrowers are essential for banks, and we can see that this factor prevails.

Question from Bloomberg:

Before asking my question, let me congratulate you on behalf of all my colleagues on the Russian President’s decision to launch the procedure for expanding your mandate. It proves that your policy is correct and, as far as I can see, everybody is satisfied with it.

My question is as follows. When you participated in the online reading of ‘The Master and Margarita’, you read a passage from Chapter 29 of the novel, in which Matthew asks Woland to let the Master have some peace. Have you asked for some peace from the President? And anticipating your answer, what will be your objectives for the new term? Thank you very much.

ELVIRA NABIULLINA:

Thank you for your question. Peace is something we can only dream of, I would say. Though I would prefer external factors to display more certainty and structural reforms to progress faster. This would make it easier for us to pursue our monetary policy.

As for objectives, our monetary policy goal is, as a I have told you today, to ensure low and stable inflation everybody could rely on and feel the benefits of. It is now clear to everyone that low inflation must be good for people because price growth does not accelerate, food prices do not grow. However, perhaps not everybody has realised the benefits of sustainably low inflation for businesses, because we are yet to assure them that inflation will indeed remain low and stable, and companies may rely on this assurance in making plans and raising investment. I hope we will be able to achieve this in the forthcoming years.

As for the development of the financial and banking sector, I would like to complete the so-called resolution policy and invest more in favourable conditions for banking and finance at large, in order to improve financial inclusion and expand the availability of financial services to customers so that they have more trust in the financial system.

The confidence in the banking system is already relatively high, but I would like to support and strengthen it. A separate task is the development of the non-bank financial sector. We have quite a small share of pension funds and insurance companies, though they are a source of long money necessary to economic development. These are the key objectives in this field.

QUESTION from Reuters:

The seasonal nature of the balance of payments makes analysts expect purchases of foreign currency conducted by the Ministry of Finance to have larger impact on the ruble exchange rate in April. Do you support this view?

And a question about methodology. Do you recognise these purchases of foreign currency, conducted by the Ministry of Finance, in international reserves?

ELVIRA NABIULLINA:

Indeed, purchases of foreign currency conducted by the Ministry of Finance affect the FX market because the Ministry of Finance is itself a buyer of foreign currency. However, reverse factors have so far offset this impact. Future developments, the impact of other factors and overall movement in the exchange rate depend on many things, including oil price dynamics.

Nevertheless, as we have said from the beginning, our joint estimates with the Ministry of Finance suggest that these purchases will not be able to considerably affect the exchange rate, nor determine its dynamics. Other factors have greater influence on the exchange rate.

As for the second question, the answer is yes, of course they are recognised in the reserves.

RIA Novosti's QUESTION:

The Ministry of Finance said that the Treasury was preparing to take over foreign currency purchases from the Central Bank. Does the Bank of Russia see any associated risks for the exchange rate, or conversely might there be some positive outcomes? Thank you.

ELVIRA NABIULLINA:

We see neither risks nor evident benefits here. This is the Ministry of Finance's decision. So far we have been acting as an agent, but this decision has been made. Its impact on the FX market is neutral.

QUESTION from Interfax:

My question is as follows. You have mentioned that the Central Bank expects banks to redeem their debts on FX refinancing in 2017. It was introduced during a period of crisis to back up external debt repayments. Am I right in thinking that the Central Bank will abrogate this instrument in 2018 or will you keep it in some other form with different conditions?

And another question, if I may. Does the Central Bank intend to introduce special instruments to provide liquidity to banks which experience difficulties after information attacks? There have already been cases when regional banks faced challenges, due not to financial difficulties but to information attacks.

ELVIRA NABIULLINA:

As for the FX refinancing instrument, I think it would be appropriate to evaluate it when it expires. We believe that it has proven to be an effective instrument which has allowed our enterprises and banks to adjust more easily to the surge in external debt repayments. We set the limit at $50 billion, with a maximum allocation of $37 billion. For now debt only slightly exceeds $5 billion. As we initially planned and stated, we will curtail its use by the end of 2017. We will progressively reduce the limits and we do not foresee any problems arising for the banking sector in repaying these funds by the end of the year.

We are not going to completely abrogate it and remove it from our toolkit. It will be a suspended instrument. We do not see any need to apply it again in the near future, but we will keep it in our toolkit.

As for the special instruments to provide liquidity, we are currently developing such a mechanism. We believe there could be liquidity provision lines for banks experiencing temporary liquidity shortages, not necessarily because of information attacks, but due also to various other factors. Having said that, we assume that these banks should be either solvent or explicitly capable of restoring their solvency independently in the near future. As we understand it, the intention is not to fund insolvent banks by means of these liquidity lines.

We are currently working to determine possible parameters of such liquidity lines and to introduce them to our toolkit, because, as you may see, structural liquidity surplus has saved us the necessity of providing refinancing. The demand for both 312P (BoR loans secured by non-marketable assets) and refinancing through the use of the Lombard list is falling. We will gradually revise these procedures. We are raising the requirements for securities to be included in the Lombard list and will continue to do so. However, you were certainly right to say that under these conditions such liquidity lines are increasing in significance in the face of unforeseen liquidity shortages in banks. We will certainly be working on it.

QUESTION from Reuters:

You have mentioned banking licences. Some large state-owned banks, such as Sberbank, as well as some bank products have increased their market share during the crisis. Being a regulator, does the Bank of Russia monitor competition in the banking market? Do you believe Russia still has a competitive banking environment? Thank you.

ELVIRA NABIULLINA:

A competitive environment is important. We do indeed monitor this. However, the present structure of the banking system has been in use for a long time, and cannot be changed overnight. Our objective is to do our best to create conditions and regulations to ensure fair competitive conditions. Not least because of that we suggest, for instance, that the Government's approaches to how and where to place budget funds and the funds of public companies be updated in order to involve not only large banks, but also small banks, using the mechanisms which will allow the Government to assess reliability of these banks.

We always make such proposals in order to ensure fair competitive conditions. We believe that a three-level system will allow improvement of the competitive environment, because small banks which have to comply with all the complex standards and Basel requirements have to compete on unequal terms due to their size. When we suggest that they focus on small and medium-sized businesses and individuals, and limit risks for large customers, but ease regulation in return, we contribute to fairer competition allowing them to develop and carve out a niche. I believe it will improve the competitive environment overall.

However, in general banks do compete with each other. This is evident from the movement of interest rates in the market. We cannot speak about monopolies here.

Allow me to make another comment, because competition is a very important subject. Why do we need to encourage competition in the banking sector? To make loans more accessible for small and medium-sized businesses. Underdeveloped competition and banking systems hit small and medium-sized businesses.

QUESTION from Bloomberg:

Two questions, if I may. Question one. The Bank of Russia had several options before this meeting: to maintain the key rate, to cut it by 25 bp or to cut it by 50 bp. How unanimous was the decision to reduce the rate by 25 bp? Did anybody want to keep the rate unchanged?

And, question two. As long as non-monetary policy-related questions have already been asked, may I also have one? According to Novaya Gazeta, roughly $22 billion was withdrawn from Russia in 2011–2014 under the so-called Moldova scheme, whereby money was withdrawn under court rulings. The Moldavian party claims that Russia did not assist but in fact impeded the investigation.

Was the Bank of Russia aware of this, and were you monitoring it somehow or countering cash withdrawals in any way? Thank you.

ELVIRA NABIULLINA:

Thank you very much. Indeed, we discussed different options about whether to keep the key rate or reduce it, we analysed the pace of reduction, all the economic data and our forecast. The final decision to cut the rate by 0.25 pp was unanimous.

As far as the Moldova scheme is concerned, it was one of the first dubious transactions we countered. We almost eliminated it and revoked licences from banks actively involved in the Moldova scheme. I am unaware of the details currently being discussed in the media, but I can say that the Bank of Russia extensively cooperates with the regulators in as far as it is competent, and while adhering to the law. We are able to provide documents, if necessary. However, I just cannot recall this case: these enquiries must have been received outside of my tenure. I cannot recall having received such enquiries over the past four years, but I will check.